



FEDERAL RESERVE BANK  
OF DALLAS

ROBERT D. McTEER, JR.  
PRESIDENT  
AND CHIEF EXECUTIVE OFFICER

February 26, 1991

DALLAS, TEXAS 75222

Notice 91-16

**TO:** The Chief Executive Officer of each  
member bank and others concerned in  
the Eleventh Federal Reserve District

**SUBJECT**

**Request for Comments on Proposed Modifications of  
Procedures Used for Measuring Fedwire Daylight Overdrafts**

**DETAILS**

The Board of Governors of the Federal Reserve System has requested comments on proposed modifications to its Payments System Risk Reduction Program. The proposed modifications affect the procedures used for measuring Fedwire daylight overdrafts as part of this program. In issuing this proposal, the Board has taken into consideration comments received on an earlier proposal to change the procedures for measuring daylight overdrafts that was issued in June 1989 (this Bank's Circulars 89-41 and 90-41). The request for comments is in two dockets.

Docket No. R-0721 proposes that the procedures used to measure daylight overdrafts be based on a modified, real-time approach to accounting for non-wire transactions. Fedwire funds and book-entry transfers would continue to be posted, for purposes of measuring daylight overdrafts, as they are measured throughout the business day. A depository institution's peak and average daylight overdrafts would be based on end-of-minute snapshots of each institution's account balance. Each institution's daily average daylight overdraft would be calculated by dividing the sum of its negative end-of-minute balances by the number of minutes in the official Fedwire operating day.

Docket No. R-0722 requests comment on a proposed amendment to Regulation J. The proposed amendment would require paying banks to make the settlement proceeds of checks presented for payment by a Federal Reserve Bank available to the Reserve Bank as early as one hour after the paying bank receives the checks. This amendment is necessary to implement the proposed method for posting check debits and credits to banks' reserve accounts in order to measure daylight overdrafts accurately, as proposed in Docket No. R-0721.

The Board must receive comments by May 31, 1991. Comments should be addressed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, D.C. 20551. All correspondence should refer to either Docket No. R-0721 or Docket No. R-0722.

#### ATTACHMENTS

Attached are copies of the Board's notices as they appear on pages 3098-3109 (Docket No. R-0721) and on pages 3047-50 (Docket No. R-0722), Vol. 56, No. 18, of the Federal Register dated January 28, 1991.


#### MORE INFORMATION

For further information on Docket No. R-0721, please contact Donna Matthews, (214) 651-6646; Virginia Rodriguez, (214) 698-4228; or James Smith, (214) 651-6140.

For further information on Docket No. R-0722, please contact Bob Whitman, (214) 698-4357, at the Dallas Office; Eloise Guinn, (915) 521-8201, at the El Paso Branch; Luke Richards, (713) 652-1544, at the Houston Branch; or Herb Barbee, (512) 978-1402, at the San Antonio Branch.

For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,



**ADDRESSES:** Comments, which should refer to Docket No. R-0721, may be mailed to the Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551, Attention: Mr. William W. Wiles, Secretary; or may be delivered to room B-2223 between 9 a.m. and 5 p.m. All comments received at the above address will be included in the public file and may be inspected at Room B-1122 between 9 a.m. and 5 p.m.

**FOR FURTHER INFORMATION CONTACT:** Edward C. Ettin, Deputy Director, Division of Research and Statistics (202/452-3368); Bruce Summers, Deputy Director (202/452-2231) or Florence Young, Assistant Director (202/452-3926), Division of Reserve Bank Operations and Payment Systems; Oliver I. Ireland, Associate General Counsel (202/452-3625) or Stephanie Martin, Attorney (202/452-3198), Legal Division; for the hearing impaired only: Telecommunications Device for the Deaf, Dorothea Thompson (202/452-3544).

**SUPPLEMENTARY INFORMATION:** One of the purposes of the Board's payments system risk reduction program is to reduce both direct credit risk to the Federal Reserve and systemic risk. Direct credit risk to the Federal Reserve could be caused by the inability of a depository institution to settle its intraday overdraft at a Federal Reserve Bank before the end of the day. The banking system would be exposed to systemic risk if a participant in a private large-dollar payments network were unable or unwilling to settle its net debit position on that network. Such failures could cause creditors of the failing institution, in turn, to be unable to settle their own commitments. Serious repercussions could, as a result, spread to other participants in the network, to other depository institutions outside of the network, and to the nonfinancial economy in general. The Federal Reserves would bear an indirect risk if a large number of depository institutions simultaneously faced severe liquidity constraints. Furthermore, on either private wire systems or Fedwire, depository institutions create risk by permitting their customers, including other depository institutions, to transfer uncollected balances over wire systems in anticipation of their coverage by the end of the day.

In June 1989, the Board requested comment on a comprehensive set of changes to its payments system risk reduction program (54 FR 26090, June 21, 1989). Those proposed changes included the pricing of daylight overdrafts in

## FEDERAL RESERVE SYSTEM

[Docket No. R-0721]

RIN 7100-AA76

### Proposals To Modify the Payments System Risk Reduction Program; Measurement of Daylight Overdrafts

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Request for comment.

**SUMMARY:** The Board is requesting comment on a proposed method for posting debits and credits to depository institutions' accounts at Federal Reserve Banks in order to measure daylight overdrafts accurately. Accurate measurement of daylight overdrafts will be necessary in order to assess fees for daylight overdrafts, which the Board anticipates implementing in the future as part of its payments system risk reduction program. The Board has also adopted minor modifications to the procedure it adopted in May 1990 for measuring book-entry securities overdrafts.

**DATES:** Comments must be submitted on or before May 31, 1991.

accounts at Reserve Banks and an overdraft measurement scheme to facilitate pricing, the inclusion of book-entry securities overdrafts in the calculation of total overdrafts, and various changes regarding the overdraft cap structure, capital measurement, and policies pertaining to U.S. agencies and branches of foreign banks. The Board adopted policies regarding book-entry securities, caps, capital, and agencies and branches of foreign banks in May 1990 (55 FR 22087, May 31, 1990). Today, the Board is publishing for comment a modified daylight overdraft measurement scheme. The Board anticipates that it will implement pricing of daylight overdrafts after a measurement scheme is finally adopted.

**Current risk reduction program.** Under the Board's risk reduction program, depository institutions establish a maximum amount of intraday overdrafts (both funds and book-entry) that they may incur over Fedwire<sup>1</sup>. The maximum, or cap, is a multiple of a depository institution's risk-based capital and is based on the depository institution's self-assessment of its own creditworthiness, credit policies, and operational controls. The guidelines for performing the self-assessment were established by the Board, and the documentation supporting each depository institution's rating is reviewed by the institution's primary supervisory agency examiners. (See 52 FR 29255, August 16, 1987.) Depository institutions with positive caps that frequently exceed their caps by material amounts solely due to book-entry securities activity must fully collateralize their overdrafts attributable to book-entry securities activity. In addition, financially healthy depository institutions with positive caps may choose to collateralize all or part of their book-entry overdrafts, even if they do not exceed their caps. Such secured book-entry securities overdrafts shall not be included with funds or uncollateralized book-entry securities overdrafts to determine an institution's adherence to its cap.

Under the current definition of daylight overdraft, Fedwire funds and book-entry securities transfers are posted as they are processed during the business day. All non-automated clearing house ("ACH"), non-wire transactions are netted at the end of the banking day; if the net is a credit, that credit is added to the opening-of-the-day balance, and if the net is a debit, the debit is deducted from the end-of-day

position. The net of all ACH transactions is posted as if the transactions occurred at the opening of business, regardless of whether the net is a debit or a credit. This *ex post* measure allows a depository institution to use all of its non-wire net credits to offset any wire debits during the day, but postpones the need to cover non-wire, non-ACH net debits until the close of the day.

**1989 pricing and measurement proposals.** The Board's June 1989 request for comment included a proposal to implement a fee at an annual rate of 25 basis points for average daily total funds and book-entry securities overdrafts in reserve or clearing accounts at Reserve Banks in excess of a deductible of 10 percent of the institution's risk-based capital. The pricing program was proposed to be phased in, with a charge of 10 basis points the first year, 20 basis points the second year, and 25 basis points in the third year and thereafter. The Board expected that explicit fees for Federal Reserve daylight credit would create incentives for depository institutions to reduce overdrafts at Reserve Banks, thereby reducing direct Federal Reserve risk and contributing to economic efficiency. The Board believes that payments system participants, as a result of the market incentives established by the combination of daylight overdraft pricing and settlement finality on CHIPS, would lower the level and more efficiently allocate the distribution of Fedwire and private-sector intraday credit flows.

The Board's daylight overdraft pricing proposal would give funds an intraday value and, therefore, would require precision in measuring intraday overdrafts. Such precision would require fixing the time at which all payment transactions by Reserve Banks are recognized to have occurred for daylight overdraft measurement purposes. The Board proposed that, for purposes of measuring daylight overdrafts, a depository institution's opening balance at the Reserve Bank be adjusted by (1) Credits for U.S. Treasury and government agency book-entry securities interest payments; (2) credits for U.S. Treasury and government agency book-entry securities redemption proceeds; (3) credits for U.S. Treasury ACH recurring credit transactions; and (4) debits for new issues of U.S. Treasury book-entry securities. During the day, Fedwire funds and book-entry securities transactions would be posted as they occurred. At 2 p.m. local time of the Reserve Bank, Treasury direct and special direct investment credits would

be posted. After the close of Fedwire, all non-wire and commercial ACH transactions would be posted, regardless of whether the net of those transactions were a credit or a debit. This overdraft measurement proposal would apply equally to all depository institutions with Reserve Bank accounts, including U.S. chartered banks, foreign banks with U.S. agencies and branches, thrifts, bankers' banks, limited purpose trust companies, nonbank banks,<sup>2</sup> and any other such entities. The current measurement scheme and the 1989 proposal are summarized in appendix 1.

**Status of pricing proposal.** The Board received 216 comments on the June 1989 pricing proposal. Nearly three-quarters of the commenters opposed the proposal, with opposition particularly intense among nonfinancial corporate users of the payments system. Banking organizations were less dramatically opposed, largely because the alternative to pricing (cap reduction) was even less preferable.

In summary, supporters of the pricing proposal focused on (1) Their preference for the use of the price mechanism to allocate and manage risk, (2) the associated benefit of structural changes that will reduce overdrafts, and (3) the inflexibility of the alternative risk reduction options. Opponents of the proposal criticized (1) The potential for gridlock and the burdens on small institutions, both of which might accompany delayed sends by larger institutions seeking to avoid overdraft fees, (2) the extra cost of control systems that might be necessary to monitor customers' overdrafts, (3) the difficulties in linking a particular customer's payments and overdrafts to the depository institution's overdrafts subject to fees, (4) the possibility that depository institutions would not build comprehensive customer controls but instead pass on overdraft fees to all customers, (5) the inability of depository institutions and their customers to avoid book-entry securities overdrafts and their associated fees, and (6) the potential impact of such fees on the operations of the U.S. government securities markets.

The Board has considered the public comments and expects to implement a pricing program for daylight overdrafts after an appropriate measurement scheme is adopted, possibly in mid-1991, to be effective in early to mid-1992.

<sup>2</sup> The posting changes would not affect the overdraft restrictions and overdraft measurement provisions for nonbank banks established by the Competitive Equality Banking Act of 1987 and the Board's Regulation Y (12 CFR § 225.52).

<sup>1</sup> Before January 10, 1991, net debits on the Clearing House Interbank Payments System ("CHIPS") were subject to Federal Reserve limits.

Should the Board adopt a pricing program, the details of the program and a full response to the public comments on pricing would be published at the time of adoption.

*Measurement of book-entry securities overdrafts.* In connection with the policy adopted in May 1990 to include book-entry securities overdrafts within the total overdraft subject to cap, the Board adopted several measurement rules relating to book-entry securities, effective January 10, 1991. Specifically, Treasury and government agency book-entry securities interest payments are posted to an institution's funds balance as of the opening of the business day. The net effect of new Treasury issues and Treasury and government agency redemptions are credited or debited to an institution's book-entry securities balance at the opening of the book-entry day. New issues of government agency securities are posted to book-entry balances as the securities are delivered over Fedwire.

It was the Board's intention that these transactions be posted shortly after the opening of Fedwire in order to provide some time for purchasers of original issues to obtain funding, if needed. The Board today is clarifying that debits for original issues of Treasury securities and credits for interest payments and redemption proceeds of Treasury and government agency securities are to be posted at 9:15 a.m. ET, effective immediately.

In addition, since the adoption of these book-entry securities measurement procedures, the Board has learned that it would be extremely difficult for the Reserve Banks to credit interest payments to depository institutions' funds balances. Because any funds overdrafts will be offset by credits in book-entry securities balances, depository institutions would not be negatively affected if credits for Treasury and government agency securities interest payments were posted to book-entry securities balances. The Board, therefore, has approved a modification to the book-entry measurement scheme whereby such credits will be posted to book-entry securities balances at 9:15 a.m. ET on the interest payment date, effective immediately.

#### *Overview of public comment on proposed posting rules*

A total of 319 commenters discussed the proposal to modify the procedures for measuring daylight overdrafts, and only one commenter supported the entire proposal. The majority of commenters, however, concurred with the Board's objective of eliminating the

intraday float that is created by the current procedures for measuring daylight overdrafts. The major issues raised by commenters concerning the proposal fell into two broad categories: (1) The effects of the proposal on current cash management practices and (2) the effects of the proposal on funds availability practices.

*Effect on Cash Management Practices.* Nearly 70 percent of the commenters believed that the proposal would disrupt current cash management practices, without reducing payments system risk. These commenters indicated that funds collected through the check and ACH mechanisms, in particular, are not inherently risky<sup>3</sup> and are routinely used on the availability date to fund investments and to meet other payment obligations. Commenters questioned whether disrupting current cash management practices is warranted. In addition, several commenters were concerned that the proposal would lead to liquidity problems and, therefore, disrupt financial markets.

The Board understands that corporate cash managers typically determine each day's funding needs early in the day and include in their determinations the value of check deposits becoming available, ACH debit transactions that are settling, and checks that must be paid that day. If additional funds are needed, investments may be liquidated or funds may be raised. If excess funds are available, investment decisions are made. Corporate cash managers estimate funding needs or excess balances on a daily basis, without considering the intraday timing of funds becoming available or the time at which payments must be made.

To the extent that corporate payments are funded through check deposits or ACH debit transactions originated by the corporation and depository institutions use the measurement procedures proposed by the Board to determine their customers' intraday account balances, corporate cash managers would not be able to use such funds to cover Fedwire funds or book-entry securities transfers. Rather, corporate cash managers would either need to borrow funds intraday in order to cover some payments or to delay investments of "excess" funds by a day to avoid borrowing funds. Thus, if

<sup>3</sup> From a credit risk perspective, the primary source of risk in collecting funds through the check and ACH debit mechanisms is return items. Because return items may not be received until four or five days after funds have been credited to collecting institutions, delaying credits on the availability date does not provide a meaningful mechanism for controlling return item risk.

corporate cash managers did not modify their practices, their costs of making payments would increase due to explicit charges for the use of daylight credit. Alternatively, returns on investments would decline.

Federal Reserve survey data support those commenters that stated that eliminating the intraday float provided through the current procedures for measuring daylight overdrafts would reduce intraday liquidity. Based on survey data for a four-week period ending August 23, 1989, the measurement scheme proposed in 1989 would have resulted in total funds and book-entry daylight overdrafts of \$144.7 billion, compared with total overdrafts of \$119.2 billion under the current measurement methodology. This increase of about \$25 billion in total overdrafts may be used as a proxy for the amount of unpriced or free liquidity that the proposal would have removed from the payments system. To put this figure in perspective, \$25 billion amounts to approximately 3 percent of daily average Fedwire funds transfer dollar volume. While reducing intraday unpriced liquidity by 3 percent is not insignificant, the reduction or elimination of float currently created by the Federal Reserve's daylight overdraft measurement procedures should cause depository institutions to modify their behavior in an attempt to avoid increasing their use of intraday credit.

*Fund Availability Practices.* Nearly 40 percent of the commenters indicated that, if the proposal were adopted, depository institutions would delay funds availability to their customers for check deposits and ACH transactions. A number of other commenters, primarily corporate credit unions and large correspondent banks, noted that adoption of the proposal would prevent them from making some payments for their customers and/or investing "excess" reserve balances.

A few commenters noted that competitive pressures should prevent depository institutions from changing their availability practices for check and ACH transactions significantly. On the other hand, adoption of the proposal might require depository institutions to use Federal Reserve credit to make funds available to customers for check deposits that are treated as next-day availability items under Regulation CC.<sup>4</sup>

<sup>4</sup> Under Regulation CC, depository institutions are required to make funds available to their customers for the following types of checks at the opening of business on the business day following the banking day of deposit: Treasury checks, Postal money orders, checks drawn on Federal Reserve Banks and

Continued

The commenters argued that the proposal to provide credit to collecting institutions after the close of Fedwire for such checks contradicted the objectives of the Expedited Funds Availability Act and Regulation CC. These commenters stated that if depository institutions are required to make funds from certain check deposits available to customers at the opening of business, funds for the collection of such items should be available for depository institutions' use at the opening of business.

Historically, the Federal Reserve has devoted considerable resources to improving deposit deadlines in order to enable depository institutions to collect more dollars within shorter time frames. These efforts have focused on improving interday funds availability, and there has been little concern about the time of day that funds were made available. The lack of focus on intraday funds availability reflects the facts that (1) no costs have been incurred when depository institutions use intraday credit, (2) the current limits on daylight overdrafts do not tend to be binding for most depository institutions, and (3) the current *ex post* measurement procedures permit collecting institutions to use the net proceeds of check and ACH transactions at the opening of business.

If fees are assessed for daylight overdrafts, attention to intraday availability of funds should increase. The Board believes that, in a pricing environment, users of Federal Reserve payments services will seek not only improved *interday* availability, but also improved *intraday* availability. Thus, even if the Board were to adopt the daylight overdraft measurement procedures proposed in 1989, it is likely that, over time, there would be strong pressures on the Reserve Banks to provide early-in-the-day availability for check and ACH transactions. Further, the private sector would likely develop such alternatives in response to the changing environment.

Some institutions whose payment activity would be constrained by their caps under the proposal stated that they may face a competitive handicap and a loss of earnings. The fundamental issue raised by these commenters is actually a funds availability issue. The Board has developed a new measurement proposal in part to address the issue of intraday funds availability. The Board was guided by the following factors: (1) The use of funds collected through the check and ACH mechanisms is not inherently risky, (2) in a pricing environment,

collecting banks will focus on obtaining earlier intraday availability, and there will be strong demand for the Reserve Banks to modify their operations in cost effective ways to provide earlier availability, and (3) some banks may not be able to provide collection services if credits for checks they collect through the Reserve Banks are not available for use during the business day.

#### *Request for Comment on Revised Measurement Scheme*

The precise measurement of daylight overdrafts requires a set of rules to determine when during the day debits and credits to a depository institution's account at a Reserve Bank are determined to have occurred. "Posting" for the purpose of measuring daylight overdrafts is not necessarily synonymous with the time at which payments become final nor the time at which the current rights to receive funds accrue, although finality of payment is one of the criteria the Board used to develop the daylight overdraft measurement rules. The actual timing of entering transactions on the Reserve Banks' books varies depending on operational procedures. Fedwire funds transactions are debited or credited as they are processed and are considered to be final payments when the receiver of funds is advised by the Reserve Bank of the credit. Non-wire payment transfers, however, generally are provisional for some period of time and refer to a particular "day" as the measuring unit of availability, without indicating the time during the day at which payment participants are either entitled to the use of the funds received or have been relieved of their payments obligation to the Federal Reserve.

Even if the Federal Reserve were not contemplating pricing Fedwire overdrafts, it would be desirable to clarify the time at which the debtor-creditor relationship between a depository institution and its Reserve Bank changes as the result of the recognition of a payment. Independent of overdraft pricing or cap policies in the United States, technology and the globalization of financial instruments and transactions are increasingly causing money, securities, and capital markets to operate on a 24-hour basis. In such an environment, trading in dollar instruments and dollar payments in one part of the world occurs while U.S. markets and Reserve Banks are closed. In a 24-hour global market, depository institutions in the United States and abroad need to know more precisely the time of day that dollar payments are recognized to have occurred by the Federal Reserve. Even if such global

developments were not in progress, a clarification would permit depository institutions to ascertain their intraday rights and responsibilities vis-a-vis Reserve Banks and to evaluate their risks accordingly.

The current transitional system of posting debits and credits for daylight overdraft measurement purposes gives the benefit of doubt to depository institutions. Two drawbacks of this system are that it creates intraday float in the measurement of daylight overdrafts in that depository institutions with net credits can use them before those with net debits are charged, and many depository institutions are unable to monitor their overdraft levels effectively during the banking day. Because the Board's payments system risk reduction program is reaching maturity, the Board believes that the initial transitional posting procedures must be modified.

In developing a proposal to establish the time at which non-wire transactions would be recognized for daylight overdraft measurement purposes, the Board was guided by a desire to eliminate the intraday float created by the current measurement procedures. Thus, the posting of a payment transaction should not result in an increase of one depository institution's credit balance (or a reduction of its measured overdraft) before another depository institution's credit balance is reduced (or its daylight overdraft is increased).

The principle of eliminating aggregate Federal Reserve intraday float is independent of the credit risk arising from the transactions. For example, there may be only minimal Federal Reserve risk resulting from granting early-in-the-day credit for checks collected through the Federal Reserve, even if the Reserve Banks do not charge paying institutions until later on the presentment day. However, by providing early-in-the-day credit to the collecting institution without an offsetting debit to the paying institution, the Federal Reserve would be permitting the collecting institution to use Federal Reserve credit without regard to that depository institution's cap, deductible, or any Reserve Bank fee. Furthermore, if explicit fees for overdrafts are adopted, and if the timing of debits and credits for each transaction were not nearly simultaneous at Reserve Banks, depository institutions would have an incentive to create float by writing checks to each other to create free overdraft capacity. As intraday credit begins to have value, either through pricing or the evolution to 24-hour global

markets, intraday Federal Reserve float becomes a subsidy.

In addition to eliminating intraday float, the new daylight overdraft measurement procedure should allow effective control of intraday overdrafts. If depository institutions are to be charged a fee for incurring a Fedwire overdraft, the procedures for measuring overdrafts should facilitate their ability to control their positions and determine their intraday balances accurately. Measurement procedures under which transactions are posted retroactively after the transaction day is complete do not meet this test.

It is important to acknowledge that any daylight overdraft measurement scheme designed to eliminate intraday float will create "winners" and "losers." (See the discussion below on the effects of the proposal on depository institutions.) The Board requests comment on whether the measurement scheme described below is an equitable balance between the positive and negative effects of the posting rules on depository institutions and their customers.

The Board requests comment on the proposed daylight overdraft measurement scheme described below (and outlined in Appendix 2). The main differences between the new proposal and the 1989 proposal are that, under the new proposal, government and commercial ACH credit transactions would be posted at the opening of business, ACH debit transactions would be posted at 11 a.m. Eastern Time ("ET"), and commercial check transactions and currency and coin deposits would be posted throughout the day, starting at 11 a.m. ET and hourly thereafter.

The features of the proposed measurement scheme are discussed in detail below:

**Commercial Check Transactions.** Commenters suggested many alternatives for posting non-wire transactions. About one-third of the commenters proposed maintaining the current *ex post* system for posting check transactions, and 85 percent of the commenters wanted to retain the current treatment of ACH debit and credit transactions. More than half of the commenters believed that check transactions should be posted during the morning on the availability or settlement day. The Board's Large-Dollar Payments System Advisory Group<sup>5</sup> suggested

<sup>5</sup> The Advisory Group, made up of private-sector payments system specialists, was formed by the

posting check transactions between 10:30 and 11:30 a.m. ET to permit depository institutions and their customers to manage their payment activity and to take advantage of a full range of investment opportunities. The Advisory Group believed that payor institutions should not be charged before checks were presented to them, but suggested that electronic presentment might be an acceptable alternative to physical presentment. At the same time, the Advisory Group acknowledged that information on certain checks could not be made available to payor institutions by the posting times it proposed and suggested that charges either be posted retroactively or the small amount of float that would be created by absorbed by the Federal Reserve. Approximately 6 percent of the commenters suggested that credits and debits for check transactions be posted throughout the day, based on the time zones of the Federal Reserve Districts on which the items are drawn.

To gain a better understanding of commenters' concerns regarding investment opportunities, the Board reviewed current investment practices. The Board found that, depending on the type of investment purchased, the investor may be required to render payment from a few minutes after the transaction is completed to the end of the business day. For example, deliveries of U.S. Treasury and agency securities take place throughout the morning and are completed by mid-afternoon. Because sellers initiate the delivery of these securities over Fedwire and the purchasers' account is charged when the securities are delivered, payment could be required minutes after the trade is negotiated.

On the other hand, for money market instruments, such as commercial paper, certificates of deposit ("CDs"), and banker's acceptances, payments are typically expected to be made in available funds by 4 p.m. ET, although most payments are made well before this deadline. In the case of Eurodollar CDs, payments normally must be made by 11 a.m. ET on the day of delivery.

While payment for some instruments must be made early in the day, it is not required for all types of investments. Nevertheless, the Board has developed an alternative measurement scheme that would provide credit for check deposits as early in the day as possible, because assessing fees for daylight overdrafts

Board in 1985 to assist in the development of the Board's payments system risk reduction program.

will create demand for early-in-the-day availability.

Under the proposed measurement scheme, depositing institutions would be credited and payor institutions would be debited intraday, based on the Reserve Banks' ability to present the checks physically to payor institutions and to obtain settlement. Under Subpart A of the Board's Regulation J (12 CFR part 210), depository institutions currently do not have an obligation to settle for checks presented by a Reserve Bank until the close of the banking day on which the checks are presented. The Board has proposed amendments to Regulation J that would allow posting of check debits to payor institutions during the day. (See Docket R-0722, elsewhere in today's Federal Register.) Under the proposed amendments to Regulation J, payor institutions would be debited for checks by the end of the clock hour after the hour during which presentment takes place. For example, checks presented at 12:30 p.m. ET would be posted at 2 p.m. ET. This would allow a payor institution at least one hour to inspect incoming cash letters and to notify its Reserve Bank of any discrepancies before the Reserve Bank posted a charge to its account.

Under this approach, Reserve Banks would begin debiting payor institutions and crediting collecting institutions at 11 a.m. ET and continue posting until 6 p.m. ET. (The last presentment to payor institutions in the Pacific Time ("PT") zone is at 2 p.m. PT, 5 p.m. ET.) This range of times was selected both to provide credit for a substantial fraction of collecting institutions' cash letters early enough in the day to allow collecting institutions to participate in financial markets and to reflect the time the Reserve Banks present checks to west coast payor institutions.<sup>6</sup>

Because checks are drawn on a large number of institutions, the Reserve Banks would base the proposed crediting scheme on the average of the actual physical presentment times for each Reserve office's availability zones, such as New York city, Boston RCPC, and Kansas City country. (High-Dollar Group Sort ("HDGS") deposits would be treated as separate availability zones.) These data would be accumulated in a matrix. The columns of the matrix would indicate the posting times, and the rows would consist of the availability zones.

<sup>6</sup> The Board considered and rejected a second alternative under which all check credits would be posted at 12 noon ET and check debits posted one hour after presentment but no earlier than 12 noon ET. This alternative would have resulted in intraday float, and this would have been inconsistent with the Board's objectives.

Thus, the matrix would reflect the fractional availability that would be granted for each availability zone. The appropriate fractions would then be applied to the dollar amount of each collecting institution's deposits to establish the times at which fractional credit would be posted for the purpose of measuring daylight overdrafts.

The following example of a HDGS cash letter illustrates the proposed crediting approach: The group sort has six endpoints, each receiving \$10,000,000 in its daily Federal Reserve presentment. The presentment time would be determined for each endpoint based on scheduled courier deliveries. Two institutions in the group sort receive their presentments before 10 a.m. ET, three institutions receive presentments between 10 a.m. ET and 11 a.m. ET, and the remaining institution receives its presentment between 12 noon ET and 1 p.m. ET. Thus, the collecting institution would receive credit for 33.3 percent of its cash letter at 11 a.m. ET (\$20,000,000 of the \$60,000,000 being presented was presented by 10 a.m. ET); another 50.0 percent of its deposit at 12:00 noon ET; and the remaining 16.7 percent at 2 p.m. ET. Each collecting institution that deposited into this HDGS program would receive the same intraday availability, regardless of the mix of items contained in its cash letter.

In a similar fashion, fractional credits would be determined for regular city, RCPC, and country deposits. Generally, fine sort and group sort cash letters would receive the fractional availability for the availability zone in which the payor institution(s) is (are) located. However, if the presentment schedules to payor institutions contained in these deposit categories differ significantly from the availability zone schedules and the dollar value of these deposits is substantial, different fractions might be developed for some fine sort and group sort deposits.

For mixed and other Fed deposits, collecting institutions would receive interday availability just as they do today. Each Federal Reserve office would calculate intraday fractional availability schedules for its mixed and other Fed deposits. In the case of other Fed deposits, the local Reserve Bank office would develop its fraction based on its ability to receive credit from other Reserve Banks, which in turn would grant availability based on their ability to present checks to payor institutions. The amount of a mixed or an other Fed cash letter that would become available on each day would be credited to the collecting institution during the day in

the same manner as credits for other types of check deposits.

It is anticipated that the fractions would be revised semiannually or when major changes in presentment schedules occurred. Once the fractions were developed, they would then be applied through the use of an automated system to the credits due to collecting institutions to calculate the amount of credit the institution would receive at each posting time on the scheduled availability day. To assist depository institutions in managing their intraday reserve/clearing account positions, information concerning the value of check credits posted at each posting time would be reflected in the Reserve Banks' Account Balance Monitoring system ("ABMS") and would be available to depository institutions in real time. Similarly, charges to payor institutions would be reflected in the ABMS at the time the payor institution's account is scheduled to be charged. Further, for those institutions that deposit checks in all Federal Reserve availability zones, the Reserve Banks would provide the fractional availability matrix in automated form.

While this measurement scheme is operationally complex for the Reserve Banks, the Board believes that it satisfies its objectives as well as the concerns raised by commenters. In addition, it represents a meaningful step toward more timely account balance information. Under this approach, nearly 50 percent of the value of all check deposits at the Federal Reserve would be made available to collecting institutions by 12 noon ET and about 78 percent would be available by 1 p.m. ET. Given the significant value of check deposits that would be available for use early in the day, it appears that the proposal would address, for the most part, the settlement needs of investors. At the same time, because funds would be made available using fractional, intraday availability schedules, cash managers may need new information systems that reflect intraday availability schedules to avoid incurring daylight overdrafts, which could increase their operating costs. Because, on average, credits for check deposits would not be posted until payor institutions had been charged for check presentments, this measurement procedure would not create intraday float.

The Board estimates that, if this proposal is adopted, a large collecting institution could be subject to 150 to 200 different sets of fractions that would be used to provide intraday availability. The Board requests comments on whether there are steps that could be

taken to reduce the complexity of its proposal and also requests comment on the following questions:

1. Under the proposal, sets of fractions would be developed for each Reserve Bank availability zone, i.e., city, RCPC, and country. In addition, each Reserve office would develop sets of fractions for its mixed and other Fed deposits. Could the number of sets of fractions be reduced by increasing the territory covered by each fraction, such as including city and RCPC endpoints in the same set of fractions?

2. Under the proposal, credit for a cash letter, e.g., an other Fed cash letter, could be passed at eight different times during the day. Would it be preferable to reduce the number of times during the day at which credit would be made available? For example, the Reserve Banks could limit the number of crediting times by only crediting collecting institutions if at least 5 or 10 percent of the value of a cash letter could be credited at the posting time.

3. In addition to providing information through the ABMS and providing the fractional availability matrix to depository institutions, what steps could the Reserve Banks implement to reduce the potential operational burden faced by collecting institutions in determining the times at which check credits would be posted?

*Next-day availability items.* Under Regulation CC, depository institutions are required to make funds available to their customers for certain check deposits at the opening of business on the business day following the banking day of deposit. Currently, the Reserve Banks provide same-day credit for deposits of separately sorted Treasury checks, Postal money orders, and checks drawn on Federal Reserve Banks that are received by late afternoon deposit deadlines, typically 4 p.m. local time. Under the June 1989 proposal, depository institutions would receive credit for these checks after the close of Fedwire on the day of deposit and the funds would be available for withdrawal at the opening of business on the following business day. The Reserve Banks' current deposit deadlines, however, can typically be met only by institutions located close to Federal Reserve offices. Most other institutions must rely on couriers to deliver their check deposits, and couriers are generally scheduled to arrive at Federal Reserve offices during the night in time to meet commercial check deposit deadlines. Thus, these institutions would not have received credit for "next day" availability items until after the close of Fedwire the day



following the business day of receipt by the institution.

Although most customers withdraw the proceeds of such deposits by check, which would not affect an institution's intraday reserve/clearing account balance until the check has cleared, customers depositing large-value checks typically use the funds for investment or other payments, withdrawing the proceeds by wire. In addition, depository institutions that receive large-value deposits frequently invest any excess funds overnight.

Under the Board's proposal, the Reserve Banks would establish a new deposit deadline for separately sorted deposits of Treasury checks, Postal money orders, and Federal Reserve Bank checks. This deposit deadline would be set at a time that corresponds to the commercial check deposit deadlines that are used by the majority of depositors in each check clearing zone. Treasury checks, Postal money orders, and Federal Reserve Bank checks received by these new deposit deadlines would be credited to depositors' accounts at the opening of business on the morning following deposit. For example, if the deposit deadline were 12:01 a.m., institutions depositing such checks would receive credit for them at the opening of business that day. The Reserve Banks would continue to offer their late afternoon deposit deadlines for same-day availability and would credit depository institutions' accounts one hour after the deposit deadline.<sup>7</sup>

The Reserve Banks are not able to identify and segregate cashier's, teller's and certified checks nor state and local government checks from the other checks drawn on the payor institutions. Moreover, even if the Reserve Banks were able to segregate these checks, as they can checks drawn on Federal Home Loan Banks, the debit could not necessarily be effected at the opening of business because the checks generally would not have been presented to the payor institution by that time. The proposal to post credits for commercial check deposits on the availability day using an intraday availability schedule should provide early-in-the-day availability for a large number of these items and, thus, should alleviate some concerns raised by commenters. It should also be noted that Treasury checks, Postal money orders, and checks

<sup>7</sup> Paid savings bonds deposited under the EZ-Clear program are processed in much the same way as Treasury checks. The Board, therefore, proposes that separately sorted deposits of paid savings bonds, deposited under the EZ-Clear program, should be treated in the same way that the Board proposes to treat Treasury checks.

drawn on Federal Reserve Banks that are included in deposits with commercial checks would typically be included in the credit posted at the first check posting time, that is, at 11 a.m. ET.

*ACH Transactions.* More than 90 percent of the commenters opposed the Board's proposal to post commercial ACH credit and debit transactions after the close of Fedwire. Commenters were particularly concerned about the different treatment that would be accorded commercial ACH credit transactions and Treasury ACH credit transactions, which would be posted at the opening of business. Commenters also indicated that the proposal would have a detrimental effect on the growth and acceptance of the ACH mechanism. Further, several commenters noted that the proposal contradicted the Federal Reserve's efforts to improve the ACH mechanism by encouraging the conversion to an all-electronic network. These commenters reasoned that, if funds would not be available for use during the settlement day, there would be little incentive for institutions to incur the expense necessary to install electronic connections in order to obtain payment data early on the settlement day. Over 85 percent of the commenters suggested that all ACH credit and debit transactions be posted at the opening of business on the settlement day.

Because information concerning ACH transactions is available to all receiving institutions no later than 7 a.m. ET, it is possible to post ACH transactions early on the settlement day without creating intraday float. Further, there are no legal obstacles that would prevent the Reserve Banks from charging originators of credit transactions or receivers of debit transactions during the settlement day. Moreover, as in the case of the check collection mechanism, the risks faced by users of the ACH mechanism are interday risks that cannot effectively be controlled by delaying depository institutions' use of funds on the settlement day.<sup>8</sup>

In developing the proposal that was issued for public comment in 1989, the Board was concerned that charging originators of ACH credit transactions at the opening of business might discourage use of the ACH, especially if

<sup>8</sup> In the case of ACH credit transactions, the Reserve Banks are exposed to the risk that the originating depository institution will not be able to fund transactions on the settlement day that it originated one or two days before that day. The Reserve Banks have the right, however, to reverse credits granted to receiving institutions if originating institutions do not fund their payments.

In the case of ACH debit transactions, the Reserve Banks are exposed to the risk created by return items, which is comparable to the return items risk faced in the check collection service.

fees were assessed for daylight overdrafts. Based on the responses received on the proposal, however, it appears that continued use of the ACH for credit transactions, such as payroll and pension payments, would be affected more by funds availability issues than by the potential overdrafts that might be created by charging originators early on the settlement day. Based on survey data for the four-week period ending August 23, 1989, modifying the Board's original proposal to post all ACH credit transactions (both debits to originating institutions and credits to receiving institutions) at the opening of business would result in a slight reduction in the total number of institutions incurring daylight overdrafts.

In the case of ACH debit transactions, cash concentration debits account for the majority of dollars collected. For the most part, cash concentration transactions are funded through check deposits that become available on the same day that the ACH debit transactions settle. By posting ACH debit transactions at 11 a.m. ET, funds would be available on a timely basis for investments and other payment obligations.

Thus, the Board proposes that both Treasury and commercial ACH credit transactions be posted at the opening of business on the settlement day. The Board also proposes that ACH debit transactions (credits to originating institutions and debits to receiving institutions) should be posted at the first check posting time, i.e., 11 a.m. ET. ACH return items and check truncation items are processed during the day for same-day availability and are normally delivered to receiving institutions in the late afternoon at approximately 4 p.m. ET. The Board proposes that these transactions be posted at 5 p.m. ET.

*Net settlement transactions.* The Reserve Banks provide net settlement services to about 200 private clearing arrangements.<sup>9</sup> The majority of net settlement arrangements enable members of local check clearinghouses to settle the checks exchanged by members through their reserve or clearing accounts. Net settlement services are also provided to members of privately operated ACH networks, automated teller machine and point-of-sale networks, and credit card processing arrangements. In addition, the Federal Reserve Bank of New York

<sup>9</sup> This discussion does not include clearing arrangements that use Fedwire to complete settlement, such as the Clearing House Interbank Payments System and Participants Trust Company.

provides net settlement service to members of the New York Clearing House Association that have agreed to exchange maturing commercial paper.

Forty-six commenters discussed issues related to the time at which net settlement entries should be posted for purposes of measuring daylight overdrafts. The majority of commenters indicated that net settlement entries for check and commercial ACH net settlement arrangements should be posted at the same time that the Reserve Banks post entries for the check and ACH transactions they process. Several commenters suggested that net settlement entries be posted at a time mutually agreed upon by the Federal Reserve and members of the clearing arrangement.

Nine commenters discussed the proposal to post net settlement entries for commercial paper transactions after the close of Fedwire. These commenters were particularly concerned about the impact the proposal would have on the commercial paper market. At least one of these commenters questioned whether the proposed Depository Trust Company ("DTC") book-entry commercial paper clearing and settlement system would significantly reduce daylight overdrafts created by commercial paper activity. This commenter noted that only the highest grades of commercial paper would be eligible for DTC's system. Some commenters encouraged the Board to post net credit entries at the opening of business and net debit entries at the close of business, while another group of commenters proposed that both net credit and net debit entries be posted between 10:30 a.m. and 12 noon ET.

The Board agrees with the commenters that net settlement entries for check and ACH clearing arrangements should, to the extent possible, be posted at a time that would permit the clearing group to provide effective services. To post offsetting net settlement entries at different times during the day, as some commenters suggested, would be inconsistent with the fundamental characteristics of the service and would create intraday float. The Board believes that the most equitable approach to addressing the issues associated with the time at which net settlement entries should be posted, for purposes of measuring daylight overdrafts, would be to permit the members of each private-sector clearing arrangement to determine the time at which the net settlement entries for its clearing arrangement would be posted. To implement such a proposal, the Reserve Banks would agree to accept

multiple settlement statements and would post net settlement entries one hour after the data were received from the agent for the clearing arrangement.

*Discount window loans.* In the Board's June 1989 proposal, both credit for extensions of discount window loans and debits for their repayment would be posted after the close of Fedwire. The Board believes that, in a pricing environment, the discount rate should be made a true 24-hour rate by matching the 24-hour maturity of a discount window loan with that of a 24-hour extension of credit in the federal funds market. In response to the introduction of daylight overdraft pricing by the Federal Reserve, participants in the federal funds market presumably would begin to price 24-hour credit extensions differently from overnight extensions. In this event, the Board believes that the 24-hour federal funds rate would be most relevant to the determination of term funds and other money market rates and, hence, of most interest in the implementation of monetary policy. The anchor to the federal funds rate stems in part from the interaction of the System's intended level of adjustment plus seasonal borrowing with the willingness of institutions to tap the discount window at the prevailing discount rate. Hence, it would seem most appropriate to link the level of borrowing to a 24-hour federal funds rate by having the maturities of discount window loans be 24 hours or multiples thereof.

Commenters on the proposal suggested that some discount window borrowers may need funds before the close of business, but may not have access to market sources of intraday credit. The Board proposes that discount window loans and repayments normally be posted after the close of Fedwire. The Board recognizes, however, that there occasionally may be circumstances that would justify permitting a depository institution to use funds advanced through the discount window during the day on which the loan is granted. Therefore, the Board proposes that, on an exception basis, if a depository institution does not have ready access to money markets and has to make unanticipated payments during the day, the Reserve Bank may post the credit for the discount window loan before the close of business and post the repayment 24 hours later.

*Treasury investments.* Two commenters indicated that the proposal to post Treasury investments at 2 p.m. local time would limit depositories' investment options and may cause some institutions to withdraw from the program. Treasury direct investments

are processed in two ways: In some cases, depositories are advised of the investment to be placed by the Treasury on the day preceding the investment date, and, in other cases, depositories are not notified until the day the investment is made. The Board proposes that Treasury investments that are known in advance be posted at the opening of business on the investment date, and that same-day Treasury investments be posted at 2 p.m. local time in order to provide the Reserve Banks sufficient time to process the transactions.

*Currency and Coin Transactions.* One commenter indicated that the proposal to post currency and coin deposits after the close of Fedwire would cause the commenter's institution to incur an overdraft if it continued to invest funds received for cash deposits as it does today. Essentially, the issue raised by this commenter is similar to the funds availability issues that were raised by commenters concerning check and ACH transactions.

Unlike the intraday posting of check transactions, the intraday posting of currency and coin transactions could be accomplished easily without creating float. Further, as in the case of check and ACH transactions, the risk faced by the Reserve Banks in granting credit for currency and coin deposits is not a risk that can be controlled through an intraday posting system. Rather, the risk is associated with potential differences in deposit amounts that can be discovered only when deposits are verified by means of piece counts, which are generally performed several days after deposits are received.

There are some differences between currency and coin deposits and check and ACH transactions. The dollar value of currency and coin deposits is relatively small compared with the dollar value of check and ACH transactions. As a result, the time at which currency and coin transactions are posted is less important to many depository institutions than the time at which checks and ACH transactions are posted. Depository institutions do not generally deposit currency and coin daily, but rather deposits are made approximately once a week. As a result, posting currency and coin deposits during the business day would not have a significant effect on average overdrafts.

While the benefits of posting currency and coin deposits during the business day on the day of deposit does not appear to be significant in absolute terms, several hundred institutions' overdrafts could be measurably reduced

if currency and coin deposits were posted during the business day. Additionally, granting credit for currency and coin deposits during the business day would substantially address the concerns of the commenters, especially smaller depository institutions, about the equity of Federal Reserve policies. The Board, therefore, proposes to post credits for currency and coin deposits on a flow basis on the day of deposit. Credits would be posted beginning at 11 a.m. ET and hourly thereafter until all credits had been posted.

Because the time at which currency and coin shipments reach depository institutions cannot be easily predicted, the Board proposes that debits for currency and coin shipments be posted after the close of Fedwire on the day the shipment is dispatched.

*Letters of Credit.* The Reserve Banks act as fiscal agents for government agencies in processing draw-downs for certain government grants. The majority of this activity is processed over Fedwire and, as a result, credits are posted to recipients' accounts when the funds transfers are processed. Some government grants, however, are processed manually by the Reserve Banks.

In many cases, the payments associated with these transactions are very large amounts, which would typically be invested on the day of receipt. Depository institutions, therefore, expect to have access to these funds on the day of receipt. From the Reserve Banks' perspective, there is no credit risk associated with handling these transactions because government agencies are obligated to fund their commitments and credits to recipients are considered final. Because payments associated with government grants are considered final payments, the Board proposes that manual letters of credit be posted to depository institutions' accounts during the business day. Under the proposal, all letters of credit that have been processed by 2 p.m. ET would be posted by that time and all transactions processed after that time would be posted by 5 p.m. ET.

*State and local government series—Treasury securities ("SLGs").* SLGs were not explicitly addressed in the Board's 1989 proposal. At least one commenter, however, questioned whether transactions in SLGs would be posted at the same times as book-entry securities transactions.

SLGs are nonmarketable securities issued by the Treasury Department to state and local governments. All records of ownership are maintained on the books of the Treasury Department. SLGs

may not be transferred as a result of sale or exchange nor may they be assigned or pledged.

While SLGs are not issued frequently, the dollar value of new issues tends to be quite large. Payments for new issues, therefore, have the potential to create significant overdrafts in certain depository institutions' accounts. Under Treasury Department procedures, purchasers must pay for new issues of SLGs either by means of a reserve account debit or a federal funds check by the close of business on the issue day.

Because the securities cannot be pledged, the collateralization policy that was implemented on January 10, 1991, to reduce the risk the Reserve Banks face in handling book-entry securities activity could not be applied to SLGs. On the other hand, because SLGs cannot be sold or transferred, they do not present the same risk to Reserve Banks as do marketable government securities. Presumably, if payment for a new issue of SLGs had not been received by the close of business on the issue day, the Treasury could reverse the subscription. In light of the limited risk faced by the Reserve Banks and the Treasury Department, the Board proposes to post debits to the accounts of depository institutions for new issues of SLGs after the close of Fedwire on the issue date.

Interest and principal payments for SLGs are made via the ACH, reserve account credit, and Treasury check. In the case of reserve account credits, the Treasury informs the Reserve Banks of payments to be made at least one business day prior to the payment date. Because payments are known in advance, the Board proposes that principal and interest payments for SLGs be posted to depository institutions' accounts at the opening of business on the interest payment and redemption dates. Payments that are made via the ACH would be posted at the same time that other ACH credit transactions are posted.

*Measurement intervals.* Currently, the *ex post* monitoring system calculates depository institutions' daylight overdrafts based on snapshots of their balances at 15 minute intervals from 8:00 a.m. until 7:00 p.m. ET. The Board is proposing modifications to the measurement intervals for two reasons: (1) The use of 15 minute snapshots of depository institutions' intraday balances does not accurately reflect many institutions' actual use of Federal Reserve credit, and (2) the time over which daylight overdrafts are measured is not consistent with Fedwire operating hours.

If it is determined to assess fees for daylight overdrafts, the accuracy of daylight overdraft calculations will take on added importance. The most accurate method of calculating daylight overdrafts would be to capture depository institutions' balances after every transaction that affects their balances. Because of the high volumes of transactions initiated and received by many institutions, this approach would be very costly to implement. Shortening the interval over which daylight overdrafts are measured would also improve the accuracy of the calculations. Based on an analysis of daylight overdraft patterns in several Federal Reserve districts, the Board proposes that depository institutions' daylight overdrafts be monitored based on snapshots of depository institutions' account balances at one minute intervals.

Because the current *ex post* monitoring system begins measuring daylight overdrafts 30 minutes before Fedwire opens and continues measuring daylight overdrafts for 30 minutes after Fedwire closes, it is possible for the system to overstate or understate a depository institution's daily average overdraft because negative or positive balances during these periods would not normally change. The Board believes that this practice is inequitable. On the other hand, Fedwire hours are extended beyond the official closing time periodically. Simulations of depository institutions' Fedwire activity during the extensions indicate that posting all Fedwire transfers sent and received during the extension at 6:30 p.m. ET would not significantly change depository institutions' average daylight overdrafts. The Board proposes that daylight overdrafts be measured over the official Fedwire operating hours, which are now 8:30 a.m. until 6:30 p.m. ET.

Under the Board's June 1989 pricing proposal, fees would be applied to each institution's daily average daylight overdraft, after reducing that average by a deductible. Based on the preceding discussion, if the Board determines to apply fees to daily average daylight overdrafts, the Board proposes that daily average daylight overdrafts be calculated by totalling each depository institution's negative account balances at the end of each minute and dividing the sum of these negative balances by the number of minutes in the official Fedwire operating day. Under this approach, only negative balances would be included in the calculation; all positive balances would be set to zero.

*Effect of Proposal on Depository Institutions.* Any modification to the current *ex post* monitoring system that eliminates intraday float will increase the level of daylight overdrafts and, most likely, the number of depository institutions incurring overdrafts, unless those institutions modify their behavior. Based on survey data for the four weeks ending August 23, 1989, under the current measurement procedures,<sup>10</sup> approximately 4,435 depository institutions would have incurred a daylight overdraft on at least one day, and daily average total Fedwire funds and book-entry overdrafts would have amounted to \$119.2 billion. Under the June 1989 proposal, about 5,627 institutions would have incurred a daylight overdraft on at least one day, an increase of nearly 1,200 institutions, and total Fedwire daylight overdraft would have amounted to \$144.7 billion, an increase of \$25.5 billion. The Board's 1989 proposal tended to increase overdrafts at depository institutions that are net collecting institutions because all non-wire credits would be posted after the close of Fedwire. Thus, if these institutions did not change their behavior, their overdrafts would have increased because they would have had to use Federal Reserve credit to continue to fund their payment activity.

The Board's new proposal for measuring daylight overdrafts would provide intraday credit to collecting institutions, but it would also charge payor institutions during the business day. Thus, a different group of institutions, i.e., net payor institutions, would be most affected by this proposal. In the aggregate, 6,565 institutions would have incurred a daylight overdraft on at least one day during the survey period, an increase of more than 2,000 institutions when compared with the current measurement procedures.<sup>11</sup> In addition, daily average total Fedwire overdrafts would have amounted to about \$152.0 billion, an increase of about \$33 billion over the current measurement procedures.<sup>12</sup>

<sup>10</sup> The current measurement procedures were adjusted to reflect the changes adopted by the Board to standardize the way that the Reserve Banks post book-entry securities transactions.

<sup>11</sup> The increase in the number of institutions incurring daylight overdrafts under the new proposal compared with the June 1989 proposal is partially due to the fact that more institutions receive check presentments from the Reserve Banks than use the Federal Reserve's check collection services directly.

<sup>12</sup> The Board believes that the increase in overdraft levels and the number of institutions incurring overdrafts under the new proposal is overstated due to limitations in the simulation that allowed only a single time for posting check debits. The Board believes a more accurate range for

A considerably larger number of institutions would be subject to the Board's risk reduction policies under the Board's new proposal than are now. About 5,000<sup>13</sup> of these institutions, however, would incur relatively small overdrafts, would qualify for the new exempt-from-filing status (see 55 FR 22092, May 31, 1990), and, as a result of the deductible, would be exempt from pricing under the 1989 pricing proposal. The daily average total overdrafts incurred by these institutions amount to only \$2.0 billion, averaging about \$400,000 per institution. Moreover, the Board believes that these simulated results overstate the level of daylight overdrafts that would result from implementation of this proposal. Further, institutions could reduce the potential overdrafts that they might incur under the proposal by delaying some non-time critical funds transfers until check credits are posted and by arranging to fund check presentments before Federal Reserve charges are posted. In the case of funding check presentments, the Large-Dollar Payments System Advisory Group has stated that it would be easier to require customers to fund check presentments during the day than to prevent customers from using funds from check and ACH transactions on the availability/settlement day. The Board, therefore, believes that many of these institutions could adjust their practices to reduce or eliminate the majority of overdrafts projected in the simulations.

Clearly, the institutions most negatively affected by the proposal are the 447 that would exceed 100 percent of their capacity. While this number is greater than the number of institutions that would have exceeded their caps under the June 1989 proposal, the number is overstated because (1) 111 institutions that currently have zero caps are eligible for either a *de minimis* or a positive cap, (2) 129 institutions that currently have positive caps would be eligible for higher caps, and (3) many institutions would not be charged for checks until later times than were used in performing the simulation upon which this analysis is based.

The daily average total overdrafts of all institutions that exceeded their caps amounted to about \$74 billion or 48 percent of daily average total overdrafts during the survey period. Of this amount

overdrafts under the new measurement proposal is \$142 to \$152 billion and the number of institutions incurring an overdraft should be between 6,000 and 6,500.

<sup>13</sup> Of the 5,133 institutions that would be exempt from filing, over 100 are considered problem institutions that would not be permitted to incur daylight overdrafts.

about \$55.8 billion reflect overdrafts in excess of cap. The majority of the excess overdrafts, \$49.2 billion, were book-entry related overdrafts incurred by securities clearing banks that must be collateralized and are exempt from cap constraints. Another \$1.0 billion of the overdrafts were due to book-entry activity and could also be collateralized and be exempted from cap constraints. The remaining \$5.6 billion in excess overdrafts appear to be attributable to a number of factors. The majority of these excess overdrafts appear to be caused by commercial paper net settlement entries. In performing the simulations, commercial paper net settlement entries were posted at 11 a.m. ET. Thus, institutions in net credit positions received their credits later than they currently do, and institutions in net debit positions received their net debits earlier. The Depository Trust Company's clearing and settlement<sup>14</sup> system should reduce some of these overdrafts because new issues of commercial paper are netted against redemptions, reducing, to some extent, the aggregate amount of the current payment flows associated with commercial paper activity. Additionally, institutions in net credit positions could delay payments that are funded by the proceeds of maturing commercial paper. Alternatively, the New York Clearing House participants could agree to a different posting time that might result in fewer overdrafts. The remaining excess overdrafts are spread among a relatively large number of institutions and appear to be due largely to the somewhat later posting time for checks credits than would be the case under the current *ex post* monitoring procedures as well as posting check debits during the business day. As noted previously, the Board believes that depository institutions could modify the timing of certain funds transfers and could require their customers to fund check presentments earlier in the day than they do now.

In summary, implementation of this proposal would require depository institutions to make adjustments, which would be necessary under any proposal that eliminates the intraday float that is created by the current measurement scheme. The Board believes that the book-entry collateralization policy that was implemented on January 10, 1991, will ease the adjustment. Under the policy, any depository institution may choose to collateralize its book-entry

<sup>14</sup> The Depository Trust Company began pricing in its book-entry commercial paper system in early October 1990.

overdrafts and will be able to continue to invest in government securities on their own behalf or on behalf of their customers without experiencing cap constraints. In the case of other payments funded by check deposits and non-wire transactions, it appears that institutions could delay many payments until funds are made available without significantly affecting payment flows. Further, because cash managers generally have fairly good information about check presentments early in the day, depository institutions could require their customers to fund check presentments before the time that the Federal Reserve charge would be posted. Finally, it can be argued that it is more equitable for payors to bear the burden associated with the elimination of intraday float because they are the parties that are responsible for making payments. If check payments were converted to electronic payments, payors would be required to have cover for payments when they were made or to pay any potential charges for extensions of intraday credit.

The Board believes that depository institutions could adjust their cash management operations in order to control the use of Federal Reserve credit. The Board requests comment on the costs depository institutions would incur on (1) A one-time basis to modify their operating systems and procedures and (2) an ongoing basis to handle daily payment activity.

#### Competitive Impact Analysis:

The Board recently formalized its procedures for assessing the competitive impact of changes that have a substantial effect on payments system participants.<sup>15</sup> Under these procedures, the Board will assess whether the proposed change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services due to differing legal powers or constraints or due to a dominant market position of the Federal Reserve deriving from such legal differences.

The Board believes that portions of the proposed daylight overdraft measurement scheme, specifically the posting scheme for check and ACH transactions, may have a direct and material adverse effect on the ability of other service providers to compete effectively with the Reserve Banks' payments services. In the case of the

Reserve Banks' check collection service, the proposed check posting procedure (and accompanying amendment to Regulation J) will enable Reserve Banks to obtain settlement in immediately available funds for checks presented to paying banks as early as one hour after presentment. In turn, Reserve Banks would be able to give credit for checks they collect earlier in the day without incurring intraday float. Private-sector collecting banks ordinarily cannot obtain settlement within a comparable time or in a comparable form without entering into an agreement with the paying bank or paying presentment fees or both.

In the case of the Federal Reserve's ACH service, the availability of funds to receivers of ACH credit transactions would be slightly more favorable than the terms of the national ACH net settlement service offered by the Reserve Banks to participants in private-sector ACH clearing arrangements. On the other hand, institutions originating ACH credit transactions through the Reserve Banks would be charged earlier that they would be under the terms of the private-sector national ACH net settlement service.

The Board believes that the proposed posting procedures should be considered within the context of the entire payments system risk reduction program and the Board's anticipated proposal regarding same-day settlement. The anticipated same-day settlement proposal would grant private collecting banks rights to receive settlement from paying banks that would be closer to the rights the Reserve Banks have under Regulation J and would mitigate the adverse competitive effects of the proposed check posting procedures. The Board believes that the advantages of the posting procedures in facilitating any future daylight overdraft pricing program and in enabling Reserve Banks to accelerate availability of check deposits outweigh the adverse effects of those procedures.

Furthermore, many of the adverse effects on the Federal Reserve's competitors in the check collection system would be mitigated by the benefits of the proposed overdraft measurement scheme. For example, under the proposed procedures, depository institutions participating in private clearinghouses would be able to establish the time at which net settlement entries for the checks exchanged among participants would be posted to reserve and clearing accounts. Thus, the participants would be able to control the time at which credits and debits would be posted to their

accounts. Correspondent banks that clear checks on behalf of respondents would be able to make payments to their respondents for any checks collected through the Federal Reserve on the settlement day without incurring daylight overdrafts, provided that the timing of payments to respondents followed the receipt of credit from the Federal Reserve.

The Board's goal of achieving accurate measurement of daylight overdrafts without incurring intraday float could be met by posting credits and debits for check and commercial ACH transactions after the close of business, as originally proposed in June 1989. The June 1989 proposal for overdraft measurement would not have caused the adverse competitive effects described above. Many of the commenters to the June 1989 proposal, however, including the Large-Dollar Payments System Advisory Group, requested the check and ACH credits and debits be posted earlier in the day to allow intraday use of funds by collecting banks. The Board requests comment, in light of the other modifications to the payments system risk reduction program proposed today and the anticipated same-day settlement proposal, on whether the ability to use check and ACH credits during the day outweighs the negative competitive effects of being charged for check and ACH transactions intraday under the proposed posting scheme.

By order of the Board of Governors of the Federal Reserve System, January 22, 1991.

William W. Wiles,  
Secretary of the Board.

#### Appendix 1—Procedures for Measuring Fedwire Daylight Overdrafts (1989 Proposal and Current)

##### 1989 Proposal

- Opening Balance (Previous day's closing balance).
- Post at Opening of Business
- + U.S. Treasury and Government Agency Book-Entry Interest and Redemption Payments.
- U.S. Treasury Book-Entry Original Issues.
- + U.S. Treasury ACH Credit Transactions.
- Post Throughout Business Day.
- + / – Fedwire Funds Transfers.
- + / – Fedwire Book-Entry Securities Transfers.
- Post at 2:00 p.m. (local time).
- + / – Treasury Investments (Direct and Special Direct).
- Post after close of Fedwire.

<sup>15</sup> These procedures are described in the Board's policy statement "The Federal Reserve in the Payments System," which was revised in March 1990. (55 FR 11648, March 29, 1990).

+/- All Other Non-Wire Transactions, Including Commercial ACH and Check Transactions  
Equals  
Closing Balance.

**Current**

Opening balance (Previous day's closing balance).  
Post at Opening of Business  
+/- U.S. Treasury and Commercial ACH Transactions.  
+ Net credits (if any) from All Other (Non-Wire) Transactions  
Post Throughout Business Day  
+/- Fedwire Funds Transfer.  
+/- Fedwire Book-Entry Securities Transfers.  
Post after close of Fedwire  
- Net Debits (if any) from All Other (Non-Wire) Transactions  
Equals  
Closing Balance.

**Appendix 2—Modified Proposal For Measuring Daylight Overdrafts**

Opening Balance (Previous Day's Closing Balance).  
Post at Opening of Business.  
+/- Government and Commercial ACH Credit Transactions.  
+ Advance Notice Treasury Investments.  
+ Treasury State and Local Government Series (SLGs) Interest and Redemption Payments.  
+ Treasury Checks, Postal Money Orders, Federal Reserve Bank Checks, and EZ-Clear Savings Bond Redemptions Deposited the Previous Night.  
Post Throughout Business Day  
+/- Fedwire Funds Transfers.  
+/- Fedwire Book-Entry Securities Transfers.  
+/- Net Settlement Entries.<sup>1</sup>  
Post at 9:15 a.m. Eastern Time  
- Original Issues of Treasury Securities.<sup>2</sup>  
+ U.S. Treasury, Government Agency Interest and Redemption Payments.  
Post at 11 a.m. Eastern Time  
+/- ACH Debit Transactions.  
Post at 11 a.m. Eastern Time and  
Hourly Thereafter:  
+/- Commercial Check Transactions, Including Return Items  
+ Currency and Coin Deposits.  
Post at 2 p.m. Eastern Time  
+ Processed Manual Letters of Credit.<sup>3</sup>

Post at 2 p.m. Local Time  
+ Same-Day Treasury Investments.  
Post One Hour After Deposit Deadline  
4-5 p.m. Local Time)  
+ Same-Day Treasury Checks, Postal Money Orders, Federal Reserve Bank Checks, and EZ-Clear Savings Bond Redemptions.  
Post at 5 p.m. Eastern Time  
+ Processed Manual Letters of Credit.<sup>4</sup>  
+/- Same-Day ACH Transactions.<sup>5</sup>  
Post After the Close of Fedwire  
+/- All Other Non-Wire Transactions (such as Noncash Items, Government Coupons, TT&L Calls, Subscription for SLGs, Discount Window Loans and Repayments,<sup>6</sup> and Currency and Coin Shipments).  
Equals.

Closing Balance.

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BILLING CODE 6210-01-M

<sup>1</sup> Net settlement entries would be posted one hour after settlement date were received by the Reserve Bank.

<sup>2</sup> Original issues of Government agency securities are delivered as book-entry securities transfers and would be posted when the securities are delivered to the purchasing institutions.

<sup>3</sup> Letters of credit transactions are draw-downs of government grants.

# Proposed Rules

Federal Register

Vol. 56, No. 18

Monday, January 28, 1991

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## FEDERAL RESERVE SYSTEM

### 12 CFR Part 210

[Regulation J; Docket No. R-0722]

#### Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Proposed rule.

**SUMMARY:** The Board is requesting comment on a proposed amendment to its Regulation J (12 CFR part 210), Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers through Fedwire. The proposed rule would require paying banks that receive presentment of checks from a Federal Reserve Bank to make the proceeds of settlement for those checks available to the Reserve Bank by as early as one hour after receipt of the checks. This amendment to Regulation J would be necessary to implement the proposed method for posting debits and credits to banks' reserve accounts in order to measure daylight overdrafts accurately under the Board's Payments System Risk Reduction Program, as proposed in Docket No. R-0721, elsewhere in today's Federal Register.

**DATES:** Comments must be submitted on or before May 31, 1991.

**ADDRESSES:** Comments, which should refer to Docket No. R-0722, may be mailed to the Board of Governors of the Federal Reserve System, 20th and C Streets NW., Washington, DC 20551, attention: Mr. William W. Wiles, Secretary; or may be delivered to room B-2223 between 9 a.m. and 5 p.m. All comments received at the above address will be included in the public file and may be inspected at room B-1122 between 9 a.m. and 5 p.m.

**FOR FURTHER INFORMATION CONTACT:** Oliver I. Ireland, Associate General Counsel (202/452-3625), Stephanie Martin, Attorney (202/452-3198), Legal

Division; or Louise L. Roseman, Assistant Director, Division of Reserve Bank Operations and Payment Systems (202/452-3874); for the hearing impaired only: Telecommunications Device for the Deaf, Dorothea Thompson (202/452-3544).

**SUPPLEMENTARY INFORMATION:** In June 1989, the Board issued for comment proposed modifications to the Federal Reserve's payments system risk reduction program (54 FR 26090, June 21, 1989). As part of the proposed program, Federal Reserve Banks would charge banks<sup>1</sup> for intraday overdrafts. To establish a framework for implementing overdraft pricing and to establish the time of day at which non-wire transactions, such as check payments, give rise to a right to receive funds or a duty to settle for the payments, the Board proposed a posting scheme whereby credits and debits associated with various transactions would be posted to accounts at specific times during the day. In developing this posting scheme, the Board was guided by certain policy objectives: To eliminate intraday Federal Reserve float (i.e., to post debits and credits associated with the same transaction at the same time), to develop a posting scheme that would allow banks to control their use of Federal Reserve credit effectively, and to reflect the legal rights associated with each transaction.

Under the June 1989 proposal, Fedwire funds transfers and book-entry securities transfers would be posted as they occur, certain U.S. Treasury transactions would be posted during the day, and all other non-wire transactions, including check debits and credits, would be posted after the close of Fedwire. The proposed posting scheme for checks differed from the current *ex post* method for measuring overdrafts under the risk program. Under the current rule, if a bank has a net credit for all non-wire transactions (other than ACH) for the day, it is posted as of the opening of business, and if the institution has a net debit, it is posted at the end of the day.

<sup>1</sup> Under Regulation J, bank includes all depository institutions, including commercial banks, savings and loan associations, and credit unions. Regulation J defines paying bank as the bank by, at, or through which an item is payable or collectible and to which it is sent for payment or collection or the bank whose routing number appears on the item and to which it is sent for payment or collection. (12 CFR 210.2 (b) and (j)).

Many of the commenters on the risk reduction proposals requested that the Board revise the proposed posting scheme so that banks could use check credits earlier in the day without risking a charge for incurring a daylight overdraft. For example, the Board's Large-Dollar Payments System Advisory Group<sup>2</sup> suggested that check debits and credits be posted between 10:30 and 11:30 a.m. Eastern Time (ET) and that appropriate amendments be made to the Board's Regulation J to accommodate an earlier posting time. According to these commenters, making check credits available earlier in the day would increase their investment opportunities and therefore the yield on the proceeds of check deposits.

The Board has requested comment today on a new proposal under which reserve and clearing accounts would be debited and credited for check transactions earlier in the day than the time proposed by the Board in 1989 (see Docket No. R-0721, elsewhere in today's Federal Register). Under the proposal, a paying bank's account would be debited on the hour, based on the value of checks that had been presented to the paying bank an hour earlier, beginning at 11 a.m. e.t. A collecting bank's account would be credited according to a fractional intraday availability schedule, beginning at 11 a.m. e.t., based on the Reserve Banks' ability to present the checks to paying banks. Adoption of this proposal would require an amendment to Regulation J to allow Reserve Banks to debit reserve and clearing accounts earlier in the day for presented checks.

#### Current Law

Subpart A of Regulation J governs the collection of checks by Federal Reserve Banks and applies to "all parties interested in an item handled by any Reserve Bank." Subpart A of Regulation J provides for deferred posting of checks, i.e., that a paying bank can wait until the day after presentment of a check to decide whether to pay the check if it settles for the check on the day of presentment.<sup>3</sup> Deferred posting

<sup>2</sup> The Advisory Group, made up of private-sector payments system specialists, was formed by the Board in 1985 to assist in the development of the Board's payments system risk reduction program.

<sup>3</sup> 12 CFR 210.3(b).

allows banks more time to process checks internally than they would have if the checks were presented over the counter for immediate payment in cash and is essential to the methods currently used by paying banks in determining whether to pay checks.

Section 210.9(a)(1) of Regulation J provides that a paying bank becomes accountable for a check presented by a Reserve Bank at the close of the paying bank's banking day on which it receives the check, unless it returns the check or settles with the Reserve Bank for the check by a debit to an account on the books of the Reserve Bank, by cash, or by another form of payment agreed to by the Reserve Bank. Section 210.99(a)(2) of Regulation J specifies that "the proceeds of any payment shall be available to the Reserve Bank by the close of the Reserve Bank's banking day on the banking day of receipt of the item by the paying bank." Under these two provisions, it appears that a paying bank must settle for a check presented to it by a Federal Reserve Bank by the earlier of the close of its banking day or the close of the Reserve Bank's banking day. As a practical matter, in many cases this time is likely to be mid-afternoon, when the paying bank closes its lobby.

Although the Uniform Commercial Code ("UCC"), as currently adopted by the states, also provides for deferred posting of checks, the time by which settlement must be made by paying banks under the UCC differs from the time for paying banks to settle for checks presented to them under the provisions of Regulation J. Section 4-302 of the UCC provides that a paying bank becomes accountable for a check unless it settles for or returns the check before midnight on the banking day it receives the check. UCC § 4-301 provides that if a paying bank settles for a check by midnight on the banking day of receipt, it may revoke that settlement if it returns the checks or sends notice in lieu of return by midnight of the banking day following the banking day of receipt.<sup>4</sup> Thus, Regulation J requires the paying bank to settle for a check presented by a Reserve Bank at an earlier time (the close of the paying bank's or the Reserve Bank's banking day) than does the UCC (midnight on the banking day of receipt)<sup>5</sup> if it wishes to retain the right

to return the check on the next banking day.<sup>6</sup>

Reserve Banks may enter into agreements with paying banks to alter this time of payment, and the Board has the ability to make further changes regarding the collection of checks under the authority of the Federal Reserve Act ("FRA"). Section 16(14) of the FRA authorizes the Board to adopt regulations concerning the transfer of funds among Reserve Banks and to require Reserve Banks to act as clearing houses for other Reserve Banks and for depository institutions. Section 13 of the FRA authorizes Reserve Banks to engage in check collection on behalf of member banks and non-member depository institutions, and section 11 grants the Board general supervisory and rule-making authority over Reserve Bank activities.

#### Proposed Regulation J Amendment to Implement Check Posting Scheme

The Board is requesting comment on a proposed amendment to Regulation J that would revise § 210.9(a)(2) to require a paying bank to settle for or return checks presented by a Reserve Bank in immediately available funds by the end of the clock hour after the hour during which presentment takes place,<sup>7</sup> or one hour after the scheduled opening of Fedwire, whichever is later, or by such later time as is provided in the Reserve Bank's operating circular. The proposed amendment provides that if the proceeds of the settlement are not available within the designated time frame, unless the check is returned, the paying bank would be subject to any applicable overdraft charges.

Under proposed § 210.9(a)(1), as long as either the proceeds of the settlement are available to the Reserve Bank by the close of Fedwire on the day the paying bank received the check or the paying bank returns the check before the close of its banking day, the paying bank would not be accountable for the check and would be able to exercise deferred posting. (The Board is also proposing a

<sup>4</sup> The Board's authority to set the time and form of settlement for checks presented by Federal Reserve Bank has been upheld by the courts on two occasions. See *Community Bank v. Federal Reserve Bank of San Francisco*, 500 F.2d 292 (9th Cir. 1974), and *Independent Banks Association of America v. Board of Governors of the Federal Reserve System*, 500 F.2d 812 (D.C. Cir. 1974).

<sup>7</sup> For example, checks presented at 12:30 p.m. e.t. must be settled for by 2 p.m. e.t. Generally, paying banks authorize Reserve Banks, through an autocharge agreement, to debit their reserve or clearing accounts for the amount of checks presented. This authorization may constitute settlement for the checks even if the Reserve Bank does not post the charge to the paying bank's account until after the time at which the settlement obligation arises.

technical revision to the definition of "banking day" to correspond to the definition in UCC § 4-104(1)(c).<sup>8</sup>

Under the proposal, if the Reserve Bank is closed on the day the paying bank receives presentment of a check, the paying bank will become subject to any applicable overdraft charges unless it either returns the check by midnight on the day of presentment or settles for the check in immediately available funds by one hour after the scheduled opening of Fedwire on the Reserve Bank's next banking day or by such later time as is provided in the Reserve Bank's operating circular. In addition, if the Reserve Bank is closed on the day the paying bank receives presentment of a check, the paying bank will become accountable for the check unless it returns the check by midnight or settles for the check in immediately available funds by the close of Fedwire on the Reserve Bank's next banking day.

If the paying bank voluntarily closes, either for the entire day or before it receives its check presentment from the Reserve Bank, on a day the Reserve Bank is open, the paying bank must either (1) return or settle for checks presented by the end of the next clock hour after the hour during which the checks would ordinarily be received by the paying bank, or one hour after the scheduled opening of Fedwire, whichever is later, or by such later time as is provided in the Reserve Bank's operating circular, or (2) settle by one hour after the scheduled opening of Fedwire on the next day on which both the paying bank and the Reserve Bank are open, or by such later time as is provided in the Reserve Bank's operating circular, and compensate the Reserve Bank for the float. Failure to settle by these times could result in the imposition of overdraft charges.<sup>9</sup>

<sup>8</sup> The citation to the 1990 Official Text is § 4-104(a)(3).

<sup>9</sup> The Board's proposed policy for institutions without discount window access, specifically bankers' banks that do not hold reserves, Edge corporations, and institutions with imposed zero caps, would provide that these institutions may not incur overdrafts. Under the proposal, issued for comment in May 1990, in the event one of these institutions incurred an overdraft, the Reserve Bank would charge it an amount equal to the overnight overdraft penalty fee (currently the federal funds rate plus 2 percent) levied against the maximum daylight overdraft level. In the event the overdraft is not fully repaid by the end of the day, the Board proposed that the institution would be charged an additional amount equal to the overnight overdraft penalty fee and would be required to hold excess balances in its reserve/clearing account on subsequent days to make up for the shortfall. If the May 1990 proposal's overdraft provisions are adopted by the Board, certain bankers' banks, Edge corporations, and imposed-zero-cap institutions

Continued

<sup>4</sup> See also §§ 4-301 and 4-302 of the 1990 Official Text of the UCC as approved by the National Conference of Commissioners on Uniform State Laws and the American Law Institute.

<sup>5</sup> Regulation J also limits the means of settlement that a paying bank may use to meet this obligation.



Generally, all checks now presented by the Federal Reserve for same-day settlement are received by the paying bank by 2 p.m. local time. Although the UCC and Regulation J generally provide an opportunity for the paying bank to examine the checks to decide whether to settle for or return them by the close of business, this time period permits only limited verification of cash letters. For example, a paying bank could verify that a cash letter had been received, but could not examine individual checks prior to settling for the cash letter. This limited verification, however, is consistent with the theory and practice of deferred posting of checks under the UCC. Paying banks generally do not examine checks individually until after the close of business on the day of presentment or during the following day. Under the proposed Regulation J amendment, paying banks will continue to have at least one hour to verify the receipt of a cash letter before settling for it or to return the cash letter and avoid having to settle for it.

In addition, earlier debiting of reserve and clearing accounts for presented checks will benefit collecting banks and their customers by enabling the Federal Reserve to credit their accounts for checks earlier in the day without incurring intraday float. This earlier availability will facilitate the prompt investment of check deposits, as suggested by the commenters to the Board's June 1989 proposal, and is consistent with the purposes of the Expedited Funds Availability Act.

Section 609(b)(1) of the Expedited Funds Availability Act provides that the Board shall consider requiring by regulation that banks be charged based upon notification that a check or similar instrument will be presented for payment. The Board may consider this option in the future but believes that, at this time, it is appropriate to require settlement only after physical presentment.

#### Proposed Amendment to Subpart B of Regulation J to Implement Pricing

In order to accommodate the possibility of pricing of overdrafts, the Board is also proposing an amendment to subpart B of Regulation J, Wire Transfers of Funds. Under the proposed amendment, an account at a Federal Reserve Bank would be subject explicitly to any applicable overdraft charges resulting from funds transfers.

would be expected to pre-fund all account debits for presented checks. If a debit for checks created an overdraft for one of these institutions, the institution would be charged whatever penalty fee the Board ultimately adopts.

#### Initial Regulatory Flexibility Analysis

The Regulatory Flexibility Act (5 U.S.C. 601-612) requires an agency to publish an initial regulatory flexibility analysis with any notice of proposed rulemaking. Two of the requirements of an initial regulatory flexibility analysis (5 U.S.C. 603(b)), a description of the reasons why action by the agency is being considered and a statement of the objectives of, and legal basis for, the proposed rule, are contained in the supplementary material above. The proposed rules require no additional reporting or recordkeeping requirements, nor are there any other relevant federal rules that duplicate, overlap, or conflict with the proposed rule.

Another requirement for the initial regulatory flexibility analysis is a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply. The proposal will apply to all banks that receive presentment of checks from Federal Reserve Banks, regardless of size. Should the Board implement pricing of daylight overdrafts and allow a percent-of-capital deductible, the small overdrafts incurred by many small banks would be covered by the deductible and exempt from pricing. Thus, the Board does not believe that small banks that incur small overdrafts would bear a significant burden under the proposed amendments to Regulation J.

#### Competitive Impact Analysis

The Board recently formalized its procedures for assessing the competitive impact of changes that have a substantial effect on payments system participants.<sup>10</sup> Under these procedures, the Board will assess whether the proposed change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services due to differing legal powers or constraints or due to a dominant market position of the Federal Reserve deriving from such legal differences.

The Board believes that, when considered alone, the proposed amendment to Regulation J may have a direct and material adverse effect on the ability of other service providers to compete effectively with the Reserve Banks' payment services. The proposed amendment will enable Reserve Banks to obtain settlement in immediately

available funds for checks presented to paying banks as early as one hour after presentment. In turn, Reserve Banks would be able to give credit for checks they collect earlier in the day without incurring intraday float. Private-sector collecting banks ordinarily can not obtain settlement within a comparable time or in a comparable form without entering into an agreement with the paying bank or paying presentment fees or both.

The Board believes, however, that when the proposed Regulation J amendment is considered within the context of the proposed payments system risk reduction program modifications (see Docket No. R-0721, elsewhere in today's Federal Register) and the Board's anticipated proposal regarding same-day settlement for private-sector collecting banks, the benefits of the Regulation J amendment in facilitating the payments system risk reduction program and enabling Reserve Banks to accelerate availability of check deposits outweigh the adverse effects. Many of the advance effects on the Federal Reserve's competitors in the check collection system would be mitigated by the benefits of the proposed overdraft measurement scheme. For example, under the proposed overdraft measurement scheme, depository institutions participating in private clearinghouses would be able to establish the time at which net settlement entries for the checks exchanged among participants would be posted to reserve and clearing accounts. Thus, the participants would be able to control the time at which credits and debits would be posted to their accounts. Correspondent banks that clear checks on behalf of respondents would be able to make payments to their respondents for any checks collected through the Federal Reserve on the settlement day without incurring daylight overdrafts, provided that the timing of payments to respondents followed the receipt of credit from the Federal Reserve.

The Board expects to request comment in the near future on a same-day settlement proposal that would grant private collecting banks rights to receive settlement from paying banks that would be closer to the rights the Reserve Banks have under Regulation J. The same-day settlement proposal would further mitigate any adverse competitive effects caused by the proposed Regulation J amendment.

The Board's goal of achieving accurate measurement of daylight overdrafts without incurring intraday float could be met by posting credits and

<sup>10</sup> These procedures are described in the Board's policy statement "The Federal Reserve in the Payments System," which was revised in March 1990. (55 FR 11648, March 29, 1990).

debits for checks presented by Reserve Banks after the close of business, as originally proposed in June 1989. The Board's June 1989 proposal for overdraft measurement would not have required an amendment to Regulation J and therefore would not have caused the adverse competitive effects described above. Many of the commenters to the June 1989 proposal, however, including the Board's Large-Dollar Payments System Advisory Group, requested that check credits and debits be posted earlier in the day to allow intraday use of funds by collecting banks. The Board requests comment, in light of the other modifications to the payments system, risk reduction program proposed today and the anticipated same-day settlement proposal, on whether the ability to use check credits during the day outweighs the negative effects of being charged for checks intraday under the proposed Regulation J amendment.

List of Subjects in 12 CFR Part 210

Banks, Banking, Federal Reserve System.

For the reasons set out in the preamble, 12 CFR part 210 is proposed to be amended as follows:

PART 210—REGULATION J (COLLECTION OF CHECKS AND OTHER ITEMS BY FEDERAL RESERVE BANKS AND FUNDS TRANSFERS THROUGH FEDWIRE)

1. The authority citation for part 210 continues to read as follows:

Authority: Federal Reserve Act, sec. 13 (12 U.S.C. 342), sec. 11 (i) and (j) (12 U.S.C. 248 (i) and (j)), sec. 16 (12 U.S.C. 248(o) and 360), and sec. 19(f) (12 U.S.C. 464); and the Expedited Funds Availability Act (12 U.S.C. 4001 et seq.)

2. Section 210.2 is amended by revising paragraph (d) and adding a new paragraph (n) to read as follows:

§ 210.2 Definitions.

(d) "Banking day" means the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions.

(n) "Fedwire" has the same meaning as that set forth in § 229.26(e) of this part.

3. Section 210.9 is amended by revising paragraph (a) to read as follows:

§ 210.9 Settlement and Payment.

(a) Cash items. (1) A paying bank becomes accountable for the amount of a cash item received directly or indirectly from a Reserve Bank as of the

close of the paying bank's banking day on which it receives <sup>2</sup> the cash item if it retains the cash item after the close of that banking day, unless it settles for the cash item by:

- (i) Debit to an account on the Reserve Bank's, books;
(ii) Cash; or
(iii) In the discretion of the Reserve Bank, any other form of settlement; so that the proceeds of the settlement are available to the Reserve Bank by the close of Fedwire on the day the paying bank receives the item.

(2) A paying bank shall settle with a Reserve Bank for the amount of a cash item received directly or indirectly from the Reserve Bank so that the proceeds of the settlement are available to the Reserve Bank by the end of the next clock hour after the hour during which the paying bank receives the cash item, or one hour after the scheduled opening of Fedwire, whichever is later, or by such later time as is provided in the Reserve Bank's operating circular, unless the paying bank returns the cash item prior to the time for settlement specified by this paragraph (a)(2). If the item is not returned and the proceeds of any settlement are not available to the Reserve Bank as required by this paragraph (a)(2), the paying bank will be subject to any applicable overdraft charges.

(3)(i) If a paying bank receives a cash item directly or indirectly from a Reserve Bank on a banking day that is not a banking day for the Reserve Bank:

(A) The paying bank will be subject to any applicable overdraft charges unless it returns the cash item by midnight of the banking day of receipt, or settles for the cash item so that the proceeds of the settlement are available to the Reserve Bank by one hour after the scheduled opening of Fedwire on the Reserve Bank's next banking day, or by such later time as is provided in the Reserve Bank's operating circular; and

(B) The paying bank becomes accountable for the cash item unless it returns the item by midnight of the banking day of receipt, or settles for the cash item so that the proceeds of the settlement are available to the Reserve Bank by the close of Fedwire on the Reserve Bank's next banking day.

(ii) If a paying bank closes voluntarily on a day that is a banking day for a Reserve Bank, and the Reserve Bank makes a cash item available to the

paying bank on that day, the paying bank will be subject to any applicable overdraft fees, unless it:

(A) Settles for the cash item, so that the proceeds of the settlement are available to the Reserve Bank by the end of the next clock hour after the hour during which the paying bank ordinarily would have received the items, or one hour after the scheduled opening of Fedwire, whichever is later, or by such later time as is provided in the Reserve Bank's operating circular;

(B) Settles for the cash item on the next day that is a banking day for both the paying bank and the Reserve Bank, so that the proceeds of the settlement are available to the Reserve Bank by one hour after the scheduled opening of Fedwire on that day, or by such later time as is provided in the Reserve Bank's operating circular, and compensates the Reserve Bank for the value of the float associated with the items in accordance with procedures provided in the Reserve Bank's operating circular; or

(C) Returns the cash item by the time designated in paragraph (a)(3)(ii)(A) of this section.

If a paying bank closes voluntarily on a day that is a banking day for a Reserve Bank, and the Reserve Bank makes a cash item available to the paying bank on that day, the paying bank is not considered to have received the item until its next banking day.

3. Section 210.28 is amended by adding a new paragraph (b)(5) to read as follows:

§ 210.28 Agreement of sender.

(b) \* \* \*

(5) If a sender, other than a government sender described in § 210.25(d) of this subpart, incurs an overdraft in its account as a result of a debit to the account by a Federal Reserve Bank under paragraph (a) of this section, the account will be subject to any applicable overdraft charges, regardless of whether the overdraft has become due and payable. A Federal Reserve Bank may debit a sender's account under paragraph (a) of this section immediately on acceptance of the payment order.

By order of the Board of Governors of the Federal Reserve System, January 22, 1991.

William W. Wiles, Secretary of the Board.

[FR Doc. 91-1902 Filed 1-25-91; 8:45 am]

<sup>2</sup> A paying bank is deemed to receive a cash item on its next banking day if it receives the item:

- (1) On a day other than a banking day for it; or
(2) On a banking day for it, but after a "cut-off hour" established by it in accordance with state law.